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FAIR LENDING CONFERENCE: HOME MORTGAGE DISCLOSURE ACT REPORT

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INTRODUCTION

Home Mortgage Disclosure Act¹ (HMDA) data may be useful in attempting to determine a pattern of discrimination within a certain geographic area. While, of course, an attorney must consider a specific individual's case when drafting a complaint, HMDA data should be analyzed in order to determine whether the case should be expanded into a class action. Unfortunately, the possibility of utilizing HMDA data for this purpose has been ignored by lawyers working in fair housing agencies. However, both in-house and external banking attorneys are indicating that they anticipate an increase in class action litigation over lending discrimination as a result of published HMDA data. It is expected that much will be published about the defenses against the utilization of HMDA data. Moreover, an attorney can effectively use HMDA data to not only identify certain lenders who are discriminating, but also to recognize mortgage market trends which may in some instances account for why the client was really denied credit.

In addition, the Loan Application Register (LAR), which is kept by lending institutions, can be used to determine if a lender has discriminated against a minority applicant who wanted to move to a predominantly white area or against a white applicant who wanted to relocate to a predominantly non-white area. The

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1. 12 U.S.C. §§ 2801-2810 (1992).

LAR may also indicate if a lender has withdrawn from a market which has become increasingly minority.

I. ACCESS TO HMDA

Analyzing HMDA data can be very intimidating. This is due to the fact that the data is not coherent data reported by competent researchers. Instead, HMDA data is the result of a pitched battle between industry lobbyists, who want the information that is reported to be limited, and housing advocates who wish to have as much data available as possible. Specifically, the HMDA is a statutory compromise between these two competing interests. Consequently, the data that is available is somewhat crude and takes some skill to analyze effectively.

While in the past obtaining HMDA data has been quite burdensome, it has recently become easier to obtain. For example, it is available on-line. In addition, software is being developed which will allow lawyers to compute basic ratings and to determine which lenders are active within a certain geographic area. Thus, technology is rendering HMDA data perhaps less intimidating to attorneys than in the past.

While HMDA data is, for the most part, reliable, there have been many reporting errors discovered in the past. For instance, a commodity organization in Pittsburgh (which was actually hired by the banks to verify the HMDA reports) found that some institutions had error rates as high as eighty-seven percent.² Likewise, a Memphis study reported that the institutions which were studied had an error rate of fifty percent. Perhaps there may be some cases where the reporting will be so defective as to give a plaintiff's attorney a new area to develop with the complaint.

In regards to HMDA data, a major point of concern is the fact that there has been an increase in the participation of mortgage brokers in many areas of the country (who may or may not be affiliated with a particular lending institution). For example, in California, brokers are now responsible for securing over half of all the mortgage loans. This is an important fact because while lending institutions report HMDA data, independent brokers do not: they are not doing the lending. If brokers are pre-screening loan applicants, this would go undetected. Consequently, it is preferable to consider the role of mortgage brokers when trying to determine sources of discrimination.

In addition to the possibility of the influence of a mortgage broker, another area which must be investigated outside of HMDA data is home equity lending. Specifically, the question is whether

2. See generally Claudia Cummins, *Latest Problem for Regulators: Bias-Data Errors*, AM. BANKER, July 23, 1993, at 1.

or not the lender grants more equity credit to white applicants than to minority applicants.

Although HMDA data may appear unintelligible, it is important for the practitioner to experiment with HMDA data in order to determine ultimately how useful it will be to clients. Since HMDA data is beginning to emerge as major research area, it is important for the practitioner to become familiar with how HMDA data fits into that practitioner's practice. As a result, the attorney will be more able to use HMDA research effectively.

II. LENDING SURVEY STUDIES

Any lawyer who is involved in or wishes to become involved in the field of housing litigation should become familiar with the lending research that is currently available. Mortgage lending research initially became available in the 1970s. The focus of the initial research was on redlining, or determining the distribution of lending authority within different metropolitan areas. At the time, the concern was the effect on older urban communities because banks were being selective in terms of to whom they extended loans. Early pioneers in the housing field (people such as Ira Goldstein, Ann Schlay, Chuck Finn, and Calvin Bradford) attempted to correlate the lending distribution data with racial characteristics of neighborhoods (which was generally determined from census data). These pioneers, by using a regression model in some cases, found that race was a distinct variable that correlated with the flow of credit into certain older urban communities which were predominantly populated by minorities. While these early studies received some attention, they were typically criticized or ignored by the lending community, and more importantly, the legislatures.

A. "The Color of Money"

The first overall recognition of housing discrimination was in 1988 when the *Atlanta Journal & Constitution* published the three-part series "The Color of Money."³ The author, Bill Dedman, investigated lending patterns of home loans over a five year period in the early 1980s.⁴ Dedman used HMDA data as well as deed transfer information and other statistics to compare census tracts which had different racial characteristics, but were similar in regards to all other critical aspects.⁵ Dedman identified sixty-four middle-income census tracts that were either eighty percent white or eighty percent African-American and found that

3. Bill Dedman, *The Color of Money*, ATLANTA J. & CONST., May 1-16, 1988.

4. *See id.*

5. *See id.*

lenders were five times more active in white neighborhoods than they were in comparable African-American neighborhoods.⁶ This finding received considerable nationwide attention.

Additionally, the Journal went on to rank the lending institutions in the area based on the ratio of African-American area lending activity. This also received considerable national attention. The fact that Bill Dedman received the Pulitzer Prize for penning "The Color of Money" also contributed to the nationwide recognition that the study received.⁷

As a result of all the controversy over the study, the Justice Department investigated the Decatur Savings & Loan and filed its first lawsuit alleging a pattern of practice of discrimination under the Fair Housing Act.⁸ Due to the incredible influence that "The Color of Money" had on litigation by the federal government, it proves valuable for an attorney involved in the field to become familiar with the publication.

B. "Boston Federal Reserve Bank Study"

Another popular study is the "Boston Federal Reserve Bank Study" which is, in reality, two distinct studies.⁹ The initial study was conducted in 1989 and was based on deed transfer information obtained from the Recorder of Deeds Office in Boston. The researchers tracked 48,000 credit transactions in 60 neighborhoods in terms of certain housing characteristics such as income. By utilizing a statistical regression model, the researchers determined there was twenty-four percent lower lending activity in predominantly African-American neighborhoods than in predominantly white neighborhoods. The researchers came to this result notwithstanding the fact that all the other variables beside race were essentially held constant. Interestingly, the Bank disclosed the study only because Congress threatened it with a subpoena. The study had an important impact because it, along with "The Color of Money," was one of the first studies to confirm that race is a statistically significant factor in terms of the ability to obtain a mortgage loan. Additionally, the 1989 Boston Reserve Bank Study is important to consider because the Bank analyzed deed transfer information as opposed to home mortgage disclosure data. The distinct advantage of using deed transfer information is that it allows one to determine the total supply of financing, including mortgage financing, within the area. While HMDA data is useful,

6. *See id.*

7. *See generally Post Reporter Wins Ford Award*, WASH. POST, Apr. 29, 1989, at A14.

8. *See 2 Fair Hous.-Fair Lending Rep. (P-H) ¶ 19,377 (N.D. Ga. 1992).*

9. Constance R. Dunham, *Geographic Patterns of Mortgage Lending in Boston, 1982-1987*, Sept.-Oct., 1989 (on file with the Boston Federal Reserve Bank).

it does not include seller financing or lending by smaller mortgage companies that are not required to report their lending under the HMDA. Consequently, deed transfer information renders the most complete picture of mortgage lending activity. While deed transfer information may not be readily accessible in areas where the Recorder of Deeds does not use computers to record data, the information has generally become more accessible in most areas.

C. Federal Reserve Board Analysis of Expanded HMDA Data

The Federal Reserve Board, in its Analysis of Expanded HMDA data in 1991, attempted to aggregate nationwide mortgage activity.¹⁰ The study was the first analysis of expanded HMDA data. While all prior HMDA data which had been released tracked only loans which the lenders granted, the expanded HMDA data contained information about both the lenders and applicants. The Board reviewed over six million applications to approximately 9,300 lending institutions in 1990.¹¹ The Board compared non-acceptance rates based on income and race using a basic statistical cross-tabulation technique. The Board concluded that lenders rejected African-American applicants 2.4 times more frequently than they rejected white applicants, and that this rate was consistent regardless of the income bracket.¹² The finding that received the most attention was that lenders rejected affluent black applicants (those having income twenty percent above the median income for the area) more frequently than they rejected low-income white applicants (those having income twenty percent below the median income for the area). Additionally, the board concluded that lenders rejected Latinos about twice as often as their white counterparts.

The Board performs this type of study annually and publishes its findings generally in October or November. According to the reports, the rejection ratios have remained essentially constant for the last three years.

D. Second Boston Federal Reserve Bank Study

The Boston Reserve Bank released its second study, analyzing 1990 lending information, in 1992.¹³ The report triggered much debate between those who felt that the 1990 data was inconclusive and those who believed the data unavoidably indicated

10. Glenn B. Canner & Dolores E. Smith, *Expanded HMDA Data on Residential Lending: One Year Later*, FED. RESERVE BULL., Nov., 1992, at 801-24.

11. See generally *id.*

12. See generally *id.*

13. LYNN E. BROWNE ET AL., MORTGAGE LENDING IN BOSTON: INTERPRETING HMDA DATA (Boston Federal Reserve Bank Study Working Paper No. 92-7, 1992).

lending discrimination within the urban mortgage market. In an attempt to make the findings more reliable, the Bank reviewed approximately 4,000 applications filed in Boston. The Bank considered thirty-eight different applicant characteristics including income, employment experience, credit history and neighborhood factors. The Board concluded that the lenders rejected minority applicants fifty-six percent more often than comparable white applicants. Additionally, the Bank concluded that the minority applicants generally had weaker credit histories and higher debt than the white applicants.

Additionally, the Bank indicated that lenders were more willing to assist white applicants by providing information than minority applicants. The Bank suggested that this may have accounted for some of the fifty-six percent discrepancy. Interestingly, the Bank found that eighty percent of all applicants have a problem with credit history. The Bank based this finding on Fannie Mae and Freddie Mac underwriting guidelines. Therefore, the Bank concluded, lenders should reject eighty percent of all applicants. However, lenders do not reject eighty percent of applicants, so the Bank concluded that loan officers waived this applicant characteristic as being non-detrimental. The Bank concluded that lenders were more likely to allow a white applicant to "explain away" credit history problems than a minority applicant. The study was the first to focus on borrower characteristics rather than merely credit flow in a certain geographic area. It devastated the industry because it was able to withstand a challenge that the data used was inconclusive and, therefore, could not be used as a basis to prove discrimination. Consequently, the study prompted many reforms. Interestingly, the Department of Justice used a very similar study to prove its case against the Decatur Savings & Loan in Atlanta.¹⁴

E. "Racial Redlining"

Jonathan Brown produced the final study which this Article addresses. The study is called "Racial Redlining" and is an analysis of credit flow.¹⁵ Brown first computed the market shares for different lenders in sixteen metropolitan areas using 1990 and 1991 HMDA data. Then, he compared how active each lender was in predominately white areas to how active each was in predominantly minority areas. Finally, Brown identified sixty-two "worse case" lending patterns for forty-nine lenders, and concluded that

14. See 2 Fair Hous.-Fair Lending Rep. (P-H) ¶ 19,377 (N.D. Ga. 1992).

15. JONATHAN BROWN, RACIAL REDLINING: A STUDY OF RACIAL DISCRIMINATION BY BANKS AND MORTGAGE COMPANIES IN THE UNITED STATES (Essential Info., Inc. 1993).

the lenders had effectively excluded minority neighborhoods. Brown asserted that the study proved discrimination. Recently, the Department of Justice used a similar study to prosecute the Chevy Chase Savings Bank for discrimination in the Washington, D.C. metropolitan area.¹⁶ Therefore, studies similar to Brown's study may turn out to be an integral part of any federal prosecution.

III. DEFENSES AND REACTIONS TO LENDING SURVEY STUDIES

Critics often attack pre-1990 HMDA data as being inconclusive because it lacks information about applications, borrower characteristics, and mortgage company activity. In fact, the data provides only information on the geography of loan origination. Since the data cannot show who is actually receiving the loans, the critics argue that the data cannot conclusively prove discrimination.

As to post-1990 HMDA data, proponents argue that the data is so staggering that it most certainly does prove some level of discrimination. However, opponents assert that other factors beside discrimination account for the data. Specifically, the opponents point out that the data lacks information such as debt ratios, income to price ratios, credit histories, employment history, and the ability to secure property insurance which may account for why the data may appear like there is discrimination. Critics are also quick to mention that there have been reports of high error rates and that the federal government has stated, in an inter-agency publication by ten agencies, that HMDA data alone does not prove lending discrimination due to the fact that it lacks certain critical information.

Nevertheless, while HMDA data may be probative of discrimination, lawyers need case law to know the power of HMDA data. For instance, whether or not HMDA data alone can make out a prima facie case is yet to be judicially decided. Other important, unanswered questions include: how must a market be defined locally; what are the appropriate variables to consider and formulae to use; and is race an accurate variable to use to measure discrimination or not due to the fact that the race of active buyers does not necessarily match that of the neighborhood?

Significantly, the Governor of the Federal Reserve Board, Larry Lindsey, has recently argued to the Boston Bar Association that statistical research would not ultimately prove discrimination in court.¹⁷ He asserted that statistical models fail to acknowledge

16. See, e.g., Jonathan D. Glater, *Justice Said to Find Bias in Lending*, WASH. POST, Oct. 25, 1994, at C5.

17. See *Detecting Discrimination by the Numbers*, MAG. BANK MGMT., Sept.

that minorities may have been rejected for loans due to legitimate reasons, and since statistical models are inadequate, the practitioner must obtain evidence to corroborate the research.¹⁸ Moreover, while the federal government has no problem producing this evidence due to its access to loan files, the private attorney must be able to withstand a motion to dismiss to get to discover this information. Unfortunately, the information may be needed in order to draft a sufficient complaint.

CONCLUSION

All the research to date forms a fairly powerful showing of discrimination and has alerted everyone that lending discrimination does exist. In contrast, before the research, whether or not lending discrimination existed was a debatable issue. However, last spring, the Chairman of the Federal Reserve Board, Alan Greenspan, acknowledged that discrimination exists in the mortgage marketplace.¹⁹ Presently the debate is over the extent of the discrimination rather than over whether or not it exists. Analyzing HMDA data may be helpful, but counsel should hire a knowledgeable statistician or economist to help understand the data and to be able to withstand attacks on the statistical validity of the research. Most significantly, the data at least increases awareness, the number of plaintiffs, and the quantity of class actions, and the data, at the least, can be a helpful tool for plaintiffs counsel.

1994, at 28.

18. *See id.*

19. *See, e.g., Lending Bias Intolerable*, ATLANTA J. & CONST., Feb. 9, 1994, at F3.